Filed 12/8/03 Cal. Fair Plan v. Boktor CA2/7

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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION SEVEN

CALIFORNIA FAIR PLAN, Plaintiff, v. NEMA BOKTOR et al. Defendant.	B160299 (Los Angeles County Super. Ct. No. BC 234590)
MAE K. WESTFALL, TRUSTEE OF THE MAE K. WESTFALL TRUST DATED SEPTEMBER 10, 1984 et al. Appellants, v. NEMA BOKTOR, Respondent.	

APPEAL from a judgment of the Superior Court of Los Angeles County. David A. Workman, Judge. Reversed with directions.

Wolf, Rifkind, Shapiro & Schulman and Simon Aron for Appellants Mae K. Westfall, Trustee of the Mae K. Westfall Trust Dated September 10, 1984, Thomas M. Westfall, Marcia L. Westfall, and Howard I. Siegel.

Law Offices of Thomas A. Nitti and Thomas A. Nitti for Respondent Nema Boktor.

Mae K. Westfall, Trustee of the Mae K. Westfall Trust Dated September 10, 1984, Thomas M. Westfall, Marcia L. Westfall and Howard I. Siegel (collectively Westfall) appeal from the judgment after court trial in this interpleader action awarding Nema Boktor (Boktor) a portion of fire insurance proceeds on property on which Westfall held a security interest. Westfall contends it was entitled to the entire amount of the proceeds under Civil Code section 2924.7 and that the trial court erred in applying the holding of *Schoolcraft v. Ross* (1978) 81 Cal.App.3d 75 to give Boktor that portion of the insurance proceeds which were in excess of the amount of Westfall's impairment. We reverse and remand.

FACTUAL BACKGROUND AND PROCEDURAL HISTORY

On December 5, 1994, Westfall loaned Boktor $75,000 evidenced by a promissory note (Note) secured by a deed of trust on rental property located on 17th Street in Santa Monica.[1] By its terms, the Note matured on December 15, 1999. The property consists of a house in front and multiple rental units in the back.

Boktor carried a fire insurance policy with California Fair Plan Association[2] on the Property in the amount of $70,000 which named Westfall as an insured. The Deed of Trust contained a clause providing that Westfall would have the right to control fire insurance proceeds.[3] In addition, under the Deed of Trust, Boktor was required to give Westfall notice of any loss or offer by the insurance carrier to settle a claim for benefits.[4]

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[1] The parties dispute whether Westfall's trust deed is a second deed of trust. At trial, Nema Boktor testified the Westfall trust deed was the only deed of trust on the Property. Westfall contended its trust deed was junior to another trust deed on the Property.

[2] After the parties were unable to resolve their disputes concerning the insurance proceeds, on August 4, 2000, California Fair Plan commenced this interpleader action and deposited the disputed funds into the trial court.

[3] "Borrower agrees to provide, maintain and deliver to Lender fire insurance satisfactory and with loss payable to Lender. The amount collected under any fire or

On July 28, 1998, the Property sustained fire damage. Boktor received insurance proceeds of $70,000 in the form of a check made payable jointly to her, the insurance adjustor and the loan servicer,[5] but did not cash the check.

Boktor obtained an estimate of $100,000 from the insurance adjustor to repair the property. Boktor intended to use the funds to pay off the note, and to get a larger loan to repair the Property.[6] In Boktor's opinion, in 1998 the Property was worth about $1 million. Westfall's loan servicer valued the Property at $400,000 in October 1999.

At the time of the fire, the payment due under the Note on July 15, 1998, had not been made, but otherwise the Note was current. The Note provided a 10-day grace period before a late fee would be due; failure to pay on the 15th of each month would constitute a default.

Boktor did not notify Westfall of the fire. Westfall learned of the fire October 29, 1999, and the parties stipulated that October 29, 1999, was the operative date for demonstrating impairment. The parties also stipulated that $10,751.90 of late payments, late charges, and fees was due under the Note as of that date. In addition, Boktor conceded property taxes of $18,305.95 were due, and the parties stipulated to the release

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other insurance policy may be applied by Lender upon any indebtedness secured hereby and in such order as Lender may determine, or at option of Lender the entire amount so collected or any part therefore may be released to the Borrower. . . ."

[4] "In the event of a loss, Borrower shall give prompt notice to the insurance carrier and Lender."

[5] The check was payable to Boktor, the Greenspan Company (the insurance adjuster) and U.S. Financial, also known as USF Services Corporation (the loan servicer).

[6] Specifically, Boktor testified that "I was going to take the money, pay what I owe with that to [Westfall], and then get a bigger loan to fix the house up with." Later in the trial, the trial court admitted that it did not recall the substance of Boktor's testimony in this regard.

of that amount from the interpleaded funds to reimburse Westfall for payment of those taxes. At the time of trial, the court held $47,394.05 of insurance proceeds.

Westfall acquired the property at a trustee's sale held April 19, 2000. Westfall acquired the property for a credit bid of $55,000. Because the accumulated charges, late fees and other costs under the Note at the time of foreclosure totaled $94,021.72, the remaining indebtedness under the Note was $39,021.72.

Westfall's property manager inspected the property after the trustee's sale, and found the front house and rental units in a state of disrepair. Westfall spent approximately $25,000 to $30,000 cleaning up, painting, carpeting, and repairing the Property. Boktor's son claimed he had spent $100,000 on the Property replacing windows, doors, carpeting, and stairs, and that this repair work was undertaken immediately after the fire. However, he submitted no documentary evidence in support of this claim. On the other hand, Westfall submitted photographs taken at the time of trial which demonstrated there still existed substantial unrepaired damage to the property.

The trial court entered judgment for Boktor, awarding Westfall $10,751.90 and releasing the balance of $36,642.15 to Boktor.[7]

DISCUSSION

Westfall contends that the trial court erred in failing to apply the directive of Civil Code section 2924.7, which permits the lender to claim insurance proceeds without regard to a showing of impairment and instead erroneously applied *Schoolcraft,* determined the extent of impairment, and gave Boktor the excess insurance proceeds.

[7] During trial, Boktor moved for a directed verdict pursuant to Code of Civil Procedure section 631.8, but the trial court denied the motion and permitted Westfall to reopen its case.

I. STANDARD OF REVIEW.

In general, a trial court's factual findings are subject to the substantial evidence rule; its conclusions of law are reviewed de novo. (*Continental Ins. Co. v. Superior Court* (1995) 32 Cal.App.4th 94, 108.) Therefore, the question of whether the trial court correctly applied Civil Code section 2924.7 and *Schoolcraft v. Ross* to the facts before it is a question of law. We review the trial court's factual findings pursuant to the substantial evidence standard of review. (*Bowers v. Bernards* (1984) 150 Cal.App.3d 870.)

II. SCHOOLCRAFT HAS NO APPLICATION WHERE THE TRUSTOR DOES NOT WISH TO REBUILD AND THE PROPERTY IS IMPAIRED.

Most deeds of trust contain a provision permitting the beneficiary to retain the proceeds of fire or other hazard insurance coverage on the encumbered property. In *Schoolcraft,* the court held that the covenant of good faith and fair dealing required that the trustor be permitted to retain the proceeds of such insurance if the beneficiary's security was unimpaired and the trustor intended to restore the property. (*Schoolcraft v. Ross, supra,* 81 Cal.App.3d at pp. 80-81.) *Schoolcraft* reasoned that the deed of trust was meant to give the trustor the use of the funds and the property, while it gave the beneficiary the right to a specified repayment over a period of time. (*Id.* at p. 80.) Absent impairment,[8] permitting the beneficiary to claim insurance proceeds resulted in an unintended acceleration of the note and deprived the trustor of its rights under the trust deed. (*Id.* at p. 81.)

In *Kreshek v. Sperling* (1984) 157 Cal.App.3d 279, the court addressed the issue of how to apportion the proceeds where the trustor did not wish to rebuild, but the

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[8] Although not precisely defined, impairment is co-extensive with "waste" under Civil Code section 2929, which defines waste as conduct which impairs the value of the security. (See, e.g., *Cornelison v. Kornbluth* (1975) 15 Cal.3d 590, 597-598 [equating impairment with waste]; see also *Nippon Credit Bank v. 1333 North Cal. Boulevard* (2001) 86 Cal.App.4th 486, 498-499 [failure to pay property taxes constitutes waste].)

security was not impaired because the property had increased in value. The trial court had divided the insurance proceeds between the beneficiary and trustor by giving the beneficiary the amount due on its note and giving the trustor the balance. (*Id.* at pp. 281-282.) *Kreshek* found that the purpose of fire insurance was to provide additional security for the note, and that the trial court's division of the proceeds in effect permitted the lender to accelerate the payments on its note without showing an impairment of the security, violating the rationale of *Schoolcraft*. In any event, *Kreshek* noted that the beneficiary's interest in the proceeds would only extend to the extent of any impairment. (*Id.* at pp. 282-283.) However, because the trial court made no finding of impairment, remand was required to determine whether and to what extent the security was impaired. (*Id.* at p. 283.)

In *Ford v. Manufacturers Hanover Mortg. Corp.* (9th Cir. 1987) 831 F.2d 1520, the court addressed the issue of whether a trustor could retain insurance proceeds to rebuild fire-damaged property where the security in the property was impaired due to default in payments under the mortgage. *Ford* concluded that where the trustor was in breach, he could not rely on the covenant of good faith and fair dealing to obtain the benefits of the contract through retention of the insurance proceeds. (*Id.* at p. 1524.)

In 1988, Civil Code section 2924.7, subdivision (b) was enacted and provided that a provision in a deed of trust permitting the beneficiary to retain the proceeds of hazard insurance was enforceable even if the security was not impaired.[9] However, the Legislative Notes indicate the Legislature's intention not "to abrogate the holding in the case of *Schoolcraft v. Ross* (81 Cal.App.3d 75) insofar as it provides that a lender may

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[9] Civil Code section 2924.7, subdivision (b) provides in full that "[t]he provisions of any deed of trust or mortgage on real property which authorize any beneficiary, trustee, mortgagee, or his or her agent or successor in interest, to receive and control the disbursement of the proceeds of any policy of fire, flood, or other hazard insurance respecting the property shall be enforceable whether or not impairment of the security interest in the property has resulted from the event that caused the proceeds of the insurance policy to become payable."

not prohibit the use of insurance proceeds for the restoration of the security property absent a showing that the lender's security interest in the property has been impaired." Furthermore, the Legislature did intend to abrogate the holdings of *Kreshek* and *Freeman*[10] "to the extent those holdings in any way restrict the right of a beneficiary or mortgagee under a deed of trust or mortgage on real property to enforce the express provisions of the deed of trust or mortgage."

We read Civil Code section 2429.7 and its legislative commentary to mean that absent a desire on the part of the trustor to rebuild, the fire insurance proceeds may be claimed by the trustor without regard to the question of impairment. This is implied by the legislature's retention of the *Schoolcraft* holding (no impairment and a desire to rebuild means the trustor can claim the proceeds) while at the same time abrogating, in the statute, the need to show impairment. Impairment only becomes germane where the trustor wishes to rebuild. Further, even if a trustor wishes to rebuild, where a showing of impairment is made, the beneficiary is entitled to the entire amount of insurance proceeds required to repay its indebtedness. This is implied by the legislature's rejection of *Kreshek,* which permitted apportionment, and Civil Code section 2429.7's silence on the issue of apportionment. Lastly, as the Ninth Circuit in *Ford* held, where a trustor who wishes to rebuild is in default, *Schoolcraft* does not apply in the first instance because the implied covenant would have no application where one party is in breach.

In the instant case, Boktor testified she wished to use the insurance proceeds to pay off the Westfall Note and after doing so to refinance the Property. This testimony alone should have put a halt to the proceedings under Civil Code section 2924.7 because she did not wish to rebuild, and the trial court erred in applying *Schoolcraft* and *Kreshek*

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[10] *Freeman v. Lind* (1986) 181 Cal.App.3d 791 found no impairment in the failure of the trustor to procure required fire insurance on the encumbered property. (*Id.* at p. 805.) "To the extent the ability of the property to act as full security for the debt is not imperiled by the lack of fire insurance, a default in the payment of insurance should not result in acceleration and foreclosure." (*Ibid.*)

to determine and apportion impairment. Even if we were to assume that Boktor wished to rebuild, or that because she intended to repair the property with another lender's funds *Schoolcraft* would apply, Boktor's numerous defaults and commissions of waste by October 29, 1999[11] constituted impairment of Westfall's security. Because of the substantial shortfall in the insurance proceeds to cover the cost of repairs and the indebtedness owed after the foreclosure sale, Westfall is entitled to the entire insurance proceeds, and the trial court erred in apportioning the proceeds under *Kreshek*.[12] Lastly, because it appears from the record as a matter of law that there is only one proper judgment in this case, we direct the trial court to enter that judgment. (Code Civ. Proc., § 43; *Conley v. Matthes* (1997) 56 Cal.App.4th 1453, 1459, fn. 7.)

DISPOSITION

The judgment of the superior court is reversed, and the trial court is directed to enter judgment for Westfall in accordance with this opinion. Appellants to recover their costs on appeal.

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[11] Boktor committed a default under the trust deed by failing to notify Westfall of the fire; the parties stipulated that $10,751.90 represented arrearages and other related charges under the Note as of October 29, 1999; and Boktor committed waste on the Property by failing to pay the property taxes. Under *Ford,* these defaults would require that the proceeds be awarded to Westfall.

[12] The issue of whether the date of loss or another date selected by the parties may be used to determine impairment is not before us on appeal, as neither party contests the use of the October 29, 1999 date. However, Boktor's attempt to argue that because she was not in default as of July 28, 1998 (the date of the fire) she is entitled to the insurance proceeds is disingenuous in light of the parties' stipulation. Her attempt to argue no impairment existed because Westfall *later* foreclosed on property with a value in excess of its note is similarly misplaced.

ZELON, J.

We concur:

JOHNSON, Acting P. J.

WOODS, J.